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COMMUNICATION FROM BRAZIL

The following communication, dated 24 July 1998, has been received from the Permanent Mission of Brazil with the request that it be circulated to Members.

Competition Policy in Brazil: Aspects of the country's recent experience

I. INTRODUCTION

The last decade has witnessed the dissemination of competition laws in several parts of the world, especially in developing countries. According to the 1997 UNCTAD World Investment Report, more than seventy nations have now competition laws, in contrast with less than forty in the 1980s. Notwithstanding the radically different environments in these different countries, competition policy tends to gain increasing importance all over.

In Brazil, although there have been laws regulating the subject since 1945 (and the country has had an entity since 1962), the competition authorities have been restructured in the nineties and the focus of their actions shifted from basically direct intervention in the market for the purpose of protecting the so-called "popular economy" (that is, essentially, controlling prices) to the analysis of mergers, abuse of dominant position and other topics more in line with the range of subjects usually identified with "modern" Competition Policy.

This submission aims at providing an overview of the situation of competition policy in Brazil, its historical evolution and the challenges the country faces with topics such as the privatization process, international cooperation and others.

II. THE BRAZILIAN EXPERIENCE: BACKGROUND

Considering its status of a developing country, with all the difficulties that entails, Brazil has had a significant development in its practice related to competition policy. The authorities have succeeded in spreading the culture of competition among most of the segments of Brazilian society, such as the private sector, the Judiciary, universities, etc.

There is, already, a significant accumulated experience in terms of dealing with cases such as the repression of horizontal and vertical agreements, merger control, conduct cases and others. The country is now, alongside with consolidating the experience already achieved, starting to explore new areas, such as the regulation of the activities of recently privatized companies and international cooperation.

Before turning to those discussions it is useful to provide an overview of the Brazilian legislation in competition policy.

A. THE CURRENT STRUCTURE OF COMPETITION POLICY ENFORCEMENT IN BRAZIL

Brazilian antitrust legislation makes reference to three different entities. CADE (Administrative Council for Economic Defense, an autonomous agency composed by six commissioners and a President appointed by the President of Republic and confirmed by the Senate for a fixed term), SDE (Secretariat for Economic Law, of the Ministry of Justice) and SEAE (Secretariat for Economic Monitoring, of the Ministry of Finance) will be referred to as entities.

Their responsibilities, according to the law, are as follows: SDE is in charge of starting and conducting investigations related to antitrust cases, as well as monitoring the market for anticompetitive practices. SEAE is responsible for preparing non-binding economic opinions on merger cases and may issue opinions in the case of anticompetitive practices. CADE is an autonomous agency that enforces the competition law in adjudicating cases, deciding on what constitutes a violation of the law and applying penalties when needed. CADE can also conduct additional investigation when necessary.

B. THE RECENT EVOLUTION OF THE SYSTEM

Considering the high degree of state intervention prevailing in Brazil during most of the import-substitution industrialization phase of the past decades, the Brazilian legislation in competition is precocious. CADE was created as far back as 1962 and has already acquired some tradition.

One can identify two distinct trends in the legislation dealing with market regulation in Brazil as well as in many other developing countries: the first one is characterized by significant direct intervention in the market for the purpose of protecting the so-called "popular economy". This type of legislation dates back to the 1930s.

Indeed, when import tariffs were high, subsidies prevailed in many sectors and the government regulated the most important prices of the economy, it was natural to have prices controlled. This trend was predominant until the late 1980s.

Three important changes occurred thereafter:

- (i) a significant trade liberalization bringing import tariffs down from an average of more than 50% to approximately 13% and eliminating several non- tariff barriers;
- (ii) privatization and deregulation of a number of important sectors of the economy;
- (iii) and, lastly, the stabilization plan launched in 1994, which succeeded in coping with the four-digit inflation process that had undermined the macro performance of the country since the late 1970s.

After a transitional period which lasted from 1991 to 1994, those changes made the "protection of the popular economy" anachronistic and the second trend of legislation became predominant.

The main law on Competition Policy in Brazil is Law 8.884 supplemented by additional legislation such as 9.021/95 and 8.137/90. It introduced some changes to the previous law, which are more in line with the international trends in antitrust regulation:

- (i) CADE was given more autonomy from the central administration and its members gained a fixed two-year term renewable once;
- (ii) the merger review system was perfected in a number of ways and put in practice for the first time.

C. NEW CHALLENGES

Brazil already has a reasonable number of administrative decisions, especially in the recent period. In 1997 the average number of decisions per month was roughly seventeen times that of the period 1994-96. More than half of the decisions were taken in the last twenty months.

However, those statistics should not lead to an underestimation of the importance of the early experience of CADE. Indeed, one can find a rich doctrinal debate as well as a few useful precedents for most of classic types of horizontal and vertical agreements. It is also noteworthy that a professional community dedicated to antitrust developed in some cities of the country.

As for the composition of the decisions (conduct and merger cases), there is now a predominance of conduct cases vis-à-vis merger review cases; the latter represented 39% of the total in the first two years of implementation under the new law as opposed to 11% in the last twenty months. The high percentage of "abusive price" cases suggests the frequency with which authorities in the past tried to use the competition law to repress what was perceived as an abuse but very often was a macro result of the inflationary process.

The vast majority of the conduct cases in the recent period has been terminated without the imposition of any penalties. In most cases, the evidence was not sufficient to continue the prosecution. Two points derive from this fact:

- (i) In countries with a past of strong state intervention this may be frequent as well as desirable. In fact, the termination of a number of old cases is positive to the extent that previous state actions are no longer causing uncertainty. This is particularly true in regard to numerous cases involving privatized companies which had been kept under investigation until last December; and
- (ii) It is urgent to build investigative capacity for which material and especially human resources are needed. Therefore, SDE is developing consistent and stable guidelines to investigation and instruction of those processes. The consistency and acceptability of the guidelines are based on the fact that renowned specialists have been contributing to its making and implementation. As a follow-up to CADE's new code of Internal Rules, a Resolution on investigation should be enacted by August after an ample and transparent consultation to national and foreign experts and to the community as a whole.

With regard to mergers, some results are noteworthy:

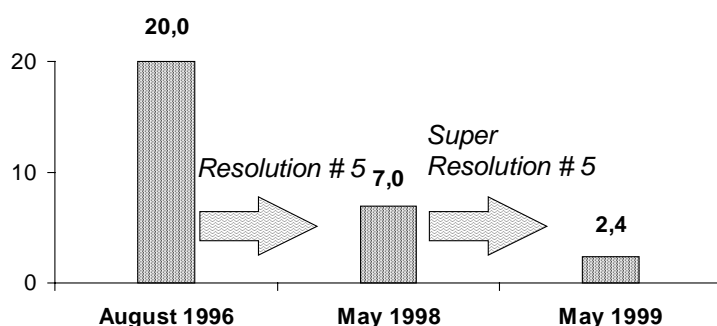
- compared to other developing countries, the number of decisions (87) as well as the content of the rulings already reveals some accumulated experience;
- the rate of disapproval in 1994-97 is relatively low and not much different from more mature jurisdictions (6%);
- most of the transactions are undertaken by foreign companies;

- and most of them are acquisitions of Brazilian companies.

One of the priorities of the Brazilian Entities has been the acceleration of the decision process on merger cases. In order to accomplish that goal a change in regulation was introduced in 1996 through legal instruments issued by the Entities (Resolution # 5 of CADE, Ordinance 163 of SEAE and Ordinance 5 of SDE). It introduced hearings with the participation of the three Entities, at which parties to a transaction expose their views and motives related to particular mergers. The basic idea was to create a fast-track procedure for cases that can be considered simple and are most likely to be approved. The average time required to analyse the operation decreased from approximately twenty months to seven months as indicated in the chart below.

A joint effort by the three entities shall lead to further improvement in merger review in the next nine months. Simplification and rationalization of the procedures, a better screening mechanism of the simpler cases and orientation to the business community should lead to a reduction of the period of the analysis from 7 to 2.4 months (see Chart). In addition, the new regulation shall be as close as possible to the framework for a merger notification form currently under discussion at the Committee on Competition Law and Policy of OECD.

Improving the Preventive Role (period of analysis in months)



III. NEW ISSUES: COMPETITION POLICY, PRIVATIZATION AND REGULATION

Besides consolidating what has already been achieved, Brazilian authorities have to prepare for the new challenges of a new model of development different from the import substitution model and integrated in a global economy.

Two lines of action are particularly important in this new context:

- privatization and the coordination between competition entities and the new regulatory authorities;
- cooperation with the other national jurisdictions.

Privatization

The Brazilian privatization programme started in the 1980s and gained *momentum* after 1991 when major state companies were transferred to the private sector. The entities have been analyzing some of these operations in the light of Law 8884. Since 1995 the privatization programme includes

sectors which have been heavily regulated in the past under the assumption that they were natural monopolies. With a new law for public concessions since 1995 and the amendments to the Constitution, it has been possible to create a new regulatory framework for these sectors. The attached note on "Competition Policy, Privatization and Regulation" describes the issue in more detail.

International Cooperation

The government of Brazil has been promoting initiatives that lead to cooperation with other national entities. The sharing of know-how and experience contributes much to the accumulation of knowledge of all the parties and to the diffusion of the culture of competition.

Different from the jurisprudence of the 1960s and 1970s, there is an increasing number of cases which not only present the same characteristics both nationally and in other markets, but also constitute, in reality, a cross-border merger or a generalized conduct. Therefore, the potential for inconsistent decisions among different national entities is high, which requires an increasing degree of coordination. Also, the frequency of cross-border transactions poses the problem of transaction costs firms incur when they have to comply with so many applications and bureaucratic timetables. Efforts to harmonize particular requirements (e.g., for merger review) could be useful even without a more profound convergence in the legislation.

Competition Policy in the MERCOSUR Customs Union

In December 1996, the MERCOSUR countries signed a protocol for the harmonization of competition policies within the trade bloc. The Protocol sets the rules that must be followed when analyzing a case with effects in more than one country of the bloc. It also regulates the functioning of a regional Competition Committee. The Protocol is presently being regulated.

IV. PERSPECTIVES OF COMPETITION POLICY IN BRAZIL: TOWARDS INSTITUTIONAL MATURITY

Together with consolidating what has already been achieved, complementary lines of action are being further explored by the Brazilian authorities. These are the improvement of the investigative capacity in conduct cases, the improvement of merger control and the continuation of the work of competition advocacy, with special emphasis on the Judiciary.

The institutional improvement of the Brazilian entities is also being enhanced. Several initiatives concerned to the modernization of their internal rules are being adopted and special attention is being given to staff training, both within the country and abroad.

In a global economy, legal certainty is a strong instrument for the attraction of foreign investment. In this context, transparent rules and respect for the due process of law contribute to the establishment of a stable environment. Also, the formation of jurisprudence constitutes an important aspect of the dissemination of the culture of competition in the world. Brazil and Mercosur are taking important steps in those directions.

ATTACHMENT

Competition Policy, Privatization and Regulation

Institutional aspects

The Brazilian Congress approved in 1995 amendments to the Federal Constitution which removed barriers to private sector participation in the areas of telecommunications, electricity, as well as in the oil sector. The amendments to the Constitution were followed by the approval of legislation creating regulatory agencies for those three sectors - namely, the National Agency for Electricity (ANEEL), the National Telecommunications Agency (ANATEL), and the National Petroleum Agency (ANP). In parallel, Congress approved, also in 1995, a law (the *concessions law*) governing the central aspects of the provision of public utilities under license agreements.

The roles of the Brazilian competition entities and that of the regulatory agencies with respect to enforcement of competition law and policies in the respective sectors is not spelled out in a systemic manner under the relevant legislation. As a general matter, the basic legislation on competition, and in particular Law 8.884 of 1994, applies without exception to regulated industries. Brazilian competition entities and the regulatory agencies have initiated discussions towards the establishment of concordats governing their relationship with respect to competition issues. It is expected that additional regulatory agencies will be set up in the future; the area of transportation is likely to be next in line.

Creating competition

A large-scale privatization programme is underway in Brazil in the areas of telecommunications and electricity, as a result of which monopolies will be replaced with competitive markets. The same will happen in the oil sector, where the state monopoly exercised by *Petrobrás*, the national oil company, will give place to competition. The following is a concise description of this process.

In the oil sector, the *petroleum law* approved by Congress provides for the creation of competitive markets in the activities of exploration and production through the participation of the private sector under license agreements. The National Petroleum Agency has already defined the acreage which will be explored by *Petrobrás*, and the fields will be up for bidding by new competitors. The terms of the standard license agreement have been defined following public discussion promoted by ANP. Also, the Brazilian government is currently defining the terms of the *government take* - including royalties and other taxes - which will apply to exploration and production of oil. In downstream activities - refining and distribution - competition, which already exists to a certain extent, will be expanded through the authorization, to be granted by ANP, for distribution companies to import oil derivatives. In preparation, the Brazilian government is currently revising the price structure of oil derivatives in Brazil, so as to bring it in line with international standards.

In telecommunications, competition will result from privatization through the sale of government-held shares in the national plant. Providers of *local services* - currently, companies operating in each of the 27 federated states - will be regrouped under 3 regional companies and privatized. As a second step, to be initiated in 1998-1999, biddings will be opened for the provision of services by a second company - the *mirror company* - in each of those three regions, thereby effectively installing competition in those markets. Embratel, the provider of *long distance and data transmission services*, will also be privatized. Effective competition will be assured as from 2003, when a second carrier will be allowed to operate the long-distance and data-transmission market.

Finally, competition has already been initiated in the market for *cellular services*: the national market was divided in 10 regions, where services began to be provided by *B-band* companies, alongside the government controlled - or *A-band* - companies, following public bidding. Government-controlled companies will now be regrouped for purposes of privatization under 8 regions. As from 2003, access to this market will be liberalized completely. Restrictions on horizontal market concentration were issued by ANATEL.

The national market for electricity is undergoing a major reshuffling, whereby the unbundling of generation, transmission and distribution activities, previously carried out by individual state-controlled companies, will be accompanied by privatization of the resulting companies, which has already begun. The unbundling, coupled with rules governing issues such as activities of independent power producers and access to transmission networks, will ensure competition. ANEEL has issued rules governing limits to participation by individual groups in each of the generation and distribution sectors, as well as cross-participation limits. Those limits may occasionally be exceeded as a result of individual privatization auctions, but divestiture rules have been issued by ANEEL to ensure that they are subsequently restored.

Finally, the Brazilian government has been adopting measures to ensure the working of effective competition in activities related to infrastructure with respect to which a regulatory agency has not yet been set up, and which are still subject to the jurisdiction of a government department. The market for air transportation services, in particular, has been subject to increased competition as a result of government action which liberalized promotional fares, the offering of charter flights, the concession of new routes, as well as access to central airports.
